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Message Text

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S E C R E T SECTION 1 OF 3 ROME 7578

EXDIS

PASS CEA FOR CHAIRMAN SCHULTZE

E. O. 11652: GDS
TAGS: EFIN, IT
SUBJ: ITALY'S CONTRIBUTION TO PAPER ON WORLD ECONOMIC OUTLOOK

REF: STATE 97516

1. DUE TO THE APRIL 25 DEADLINE, WE ARE CABLING THE PAPER PREPARED BY THE ITALIAN TREASURY MINISTRY AS ITS CONTRIBUTION TO CHAIRMAN SCHULTZE'S PAPERS ON THE WORLD ECONOMIC OUTLOOK.

2. BEGIN TEXT

I. THE MACRO-ECONOMIC SITUATION OF ITALY IN 1978

A) THE RESULTS OF MONETARY POLICY ACTIONS IN 1977

DURING 1977 THE ECONOMIC POLICY ACTIONS UNDERTAKEN BY THE ITALIAN GOVERNMENT MADE IT POSSIBLE TO ACHIEVE A BETTER FINANCIAL EQUILIBRIUM, OF WHIKX THE SALIENT FEATURES ARE A REVERSAL OF THE TREND OF FOREIGN ACCOUNTS AND A MARKED SLOWDOWN OF THE RATE OF INFLATION. HOWEVER, THE PRICE PAID FOR THESE RESULTS IS A DECELERATION

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OF DOMESTIC DEMAND, A SLACKENING OF INDUSTRIAL PRODUCTION AND A STANDSTILL IN EMPLOYMENT.

FEW FIGURES SUFFICE TO ILLUSTRATE THE SITUATION BETTER THAN ANY COMMENT: THE CURRENT BALANCE OF PAYMENTS ON A TRANSACTIONS BASIS CLOSED IN 1977 WITH A SURPLUS OF PLUS 1,860 BILLION LIRE (PLUS 2.1 BILLION US DOLLARS), COMPARED

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WITH A DEFICIT OF MINUS 2,360 BILLION LIRE IN 1976 (MINUS 2.7 BILLION US DOLLARS); THE PERFORMANCE OF PRICES, CALCULATED ON CONSUMER PRICES, RECORDED BETWEEN FEBRUARY 1977 AND FEBRUARY 1978 A DECREASE FROM AN ANNUAL RATE OF 23 PERCENT TO ONE OF 12.7 PERCENT; THE VOLUME OF FOREIGN EXCHANGE RESERVES FREELY AVAILABLE FOR FINANCING BALANCE OF PAYMENTS DEFICITS (EXCLUDING GOLD) INCREASED IN 7&77 FROM 2,794 MILLION DOLLARS TO 7,821 MILLION DOLLARS, NET OF REPAYMENTS OF SOME QUOTAS OF LOANS; THE LIRA REMAINED BASICALLY STABLE ON INTERNATIONAL FOREIGN EXCHANGE MARKETS.

TURNING TO THE NEGATIVE ASPECTS: THE GROSS DOMESTIC PRODUCT OF ITALY INCREASED IN 1977 BY BARELY 1.7 PERCENT, WHILE THE SHARE OF INVESTMENTS IN TOTAL DOMESTIC SPENDING DROPPED FROM 23.3 PERCENT TO 21 PERCENT; INDUSTRIAL PRODUCTION UNDERWENT A CLEAR SLOWDOWN DURING THE YEAR, WITH AN INCREASE, BETWEEN JANUARY AND DECEMBER, OF BARELY 0.8 PERCENT; UTILIZATION OF INDUSTRIAL PLANT DECREASED FROM 75.1 PERCENT IN THE FIRST QUARTER OF THE YEAR TO 71.5 PERCENT IN THE FOURTH; EMPLOYMENT RMAINED MORE OR LESS STATIONARY, BUT THE UNEMPLOYMENT RATE ROSE FROM THE PREVIOUS YEAR, REACHING 7.1 PERCENT OF THE TOTAL LABOR FORCE.

B) FORECAST FOR 1978 AND 1979

THE MILD SIGNS OF RECOVERY IN INDUSTRIAL PRODUCTION EN NOT
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HERALD A REAL TURNING POINT FOR THE ECONOMY. THE REVIVAL OF PRODUCTION IS AS YET VERY SLIGHT (PLUS 1.7 PERCENT IN JANUARY AND PLUS 1.7 PERCENT IN FEBRUARY) AND INVESTMENT PROGRAMS EXTREMELY LIMITED. WITHOUT NEW ECONOMIC POLICY ACTIONS, THE GROWTH RATE OF THE ITALIAN ECONOMY IN 1978 WOULD BE AROUND 2-3 PERCENT, WHEREAS THE TARGET RATE SET IN THE GOVERNMENT PROGRAM IS 4.50 PERCENT AT END-1978, TOGETHER WITH NO MORE THAN A 13 PERCENT INCREASE IN PRICES, A BALANCE OF PAYMENTS EQUILIBRIUM THAT WILL ENABLE US TO REPAY MATURING LOANS AND TAKE OUT NEW ONES, AND A CASH DEFICIT FOR THE PUBLIC SECTOR IN THE BROADER SENSE (STATE SECTOR, SOCIAL SECURITY INSTITUTIONS, LOCAL AUTHORITIES, HOSPITALS AND ENEL) THAT WILL LEAVE SUFFICIENT ROOM (AT LEAST 16,000 BILLION LIRE) NOT TO EXCEED THE 40,000 BILLION CEILING ON TOTAL DOMESTIC CREDIT EXPANSION.

THE PERSISTENTLY POOR GROWTH OF THE WORLD ECONOMY IS PREJUDICIAL TO THE GROWTH OF THE ITALIAN ECONOMY, DEFERRING THE START OF A MORE VIGOROUS RECOVERY IN 1978. THIS MEANS THAT PROJECTIONS MUST OF NECESSITY STRETCH INTO 1979, WHEN IT IS HOPED THAT THE GROWTH RATE OF ITALY'S GDP WILL DOUBLE COMPARED WITH 1978, AND THE BALANCE OF PAYMENTS STILL RETAIN A REASONABLE DEGREE OF EQUILIBRIUM. PRICES ARE EXPECTED TO SHOW A

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GRADUAL SLOWDOWN IN 1979 THAT MIGHT ALLOW US TO SEE THE LAST OF
TWO-DIGIT INFLATION.

HOWEVER, THE VALIDITY OF GROWTH FORECASTS FOR 1979,
AS FOR 1978, DEPENDS ON A REASONABLE GROWTH RATE FOR OUR EXPORTS,
WHICH SHOULD NOT FALL BELOW 5.5 - 6 PERCENT IN REAL TERMS.
FINALLY, INVESTMENT SHOULD EXPAND IN REAL TERMS BY AT LEAST 6
PERCENT WITH RESPECT TO THE PREVIOUS YEAR.

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C) THE MONETARY, FISCAL AND INCOMES POLICY UNDERLYING THE
MACRO-ECONOMIC SITUATION

THIS POLICY IS OUTLINED IN THE GOVERNMENT PROGRAM PRESENTED TO
PARLIAMENT ON MARCH 16 THIS YEAR.

IN ADDITION TO THE FRAME OF REFERENCE SET OUT UNDER THE PRECEDING
POINT B), IT INCLUDES:

--ANY STEPS NECESSARY TO ENCOURATE THE SOCIAL FORCES TO
KEEP WAGE CLAIMS WITHIN LIMITS THAT ARE CONSISTENT WITH THE TREND
OF OTHER COMPETITOR COUNTRIES AND THAT DO NOT GO BEYOND DEFENDING
REAL WAGES AND EQUALIZING THE LOWEST WAGES,

--AN UNDERTAKING BY BUSINESSMEN NOT TO GRANT UNILATERAL WAGE
INCREASES OF ANY TYPE WHATSOEVER BETWEEN ONE CONTRACT AND THE NEXT,

--ADDITIONAL TAX LEVIES IN 1978, FOR A TOTAL YIELD OF 1,650
BILLION (TAKING INTO ACCOUNT THAT SOME MEASURES WILL NOT APPLY
THROUGHOUT THE ENTIRE YEAR), TO BE OBTAINED AS FOLLOWS:

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----RECOVERY OF TAX-EVASION IN VARIOUS SECTORS,

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----DIRECT TAXATION (BRINGING INTO LINE TAX RATES ON SOME
CAPITAL EARNINGS AND REVISING SLIGHTLY WITHHOLDING TAXES)

----VARIOUS INDIRECT TAXES.

AS REGARDS PUBLIC UTILITY CHARGES (WITHOUT PREJUDICE TO THE
PRINCIPLE OF DIFFERENTIATING BETWEEN "SOCIAL GROUPS" FOR SUBSIDIZED
CONSUMPTION), THERE WILL BE A REVISION OF ELECTRICITY RATES,
RAIL FARES, AND THE CHARGES FOR LOCAL SERVICES (PARTICULARLY
TRANSPORT).

THE ENTIRE OPERATION TO REDUCE THE DEFICIT OF THE PUBLIC SECTOR
IN THE BROADER SENSE BY 9,000 BILLION WILL MAKE AVAILABLE
FINANCIAL RESOURCES THAT CAN IN PART BE ALLOCATED TO SUPPLE-
MENTARY INTERVENTIONS TO STIMULATE AND RELAUNCH THE ECONOMY, AND
SPECIFICALLY IN ORDER TO INCREASE EMPLOYMENT IN THE MEZZOGIORNO.
THE FIGURE IN QUESTION WOULD BE 4,000 BILLION LIRE.

PUBLIC SUPPORT TO THE RECOVERY OF PRODUCTION WILL
CHIEFLY TAKE THE FORM OF CURBS ON DEMAND IN THE FOLLOWING SECTORS:

-- ENERGY

-- RAIL TRANSPORT (ROLLING STOCK), IN CONNECTION WITH THE
PROJECT TO MODERNIZE THE STATE RAILWAYS

--TELEPHONES
--HOUSING,

3. II. FORECASTS CONCERNING OTHER COUNTRIES

THE FORECASTS OF GROWTH OF THE WORLD ECONOMY IN 1978 ARE RATHER
MODEST: 4 PERCENT IN THE INDUSTRIALIZED COUNTRIES ALONE (ACCORDING

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TO RECENT IMF CALCULATIONS), 5.3 PERCENT IN THE MAIN OIL-EXPORT-
ING COUNTRIES, EVEN LESS IN THE EMERGENT NATIONS. BUT THE LEAST
SATISFACTORY FIGURES ARE THOSE FOR THE SEVEN MAJOR INDUSTRIALIZED
COUNTRIES AS A WHOLE, FOR WHICH THE AVERAGE GROWTH OF GNP IS
ESTIMATED BY THE IMF AT BARELY 2.2 PERCENT IN THE FIRST OF
THE YEAR AND 2.4 PERCENT IN THE SECOND HALF.

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THE FORECAST DEVELOPMENT OF WORLD TRADE IN REAL TERMS IN 1978
IS JUST 5 PERCENT, THE SAME, THAT IS, AS IN 1977, WHILE HOPES FOR
1979 (FIRST HALF) ARE NOT MUCH BETTER (6 PERCENT). UNDER THESE
CONDITIONS IT SHOULD COME AS NO SURPRISE IF, GIVEN UNDER-UTILI-
ZATION OF RESOURCES IN ALL COUNTRIES, HIGH UNEMPLOYMENT RATES AND
LOW RATES OF INVESTMENT, THE SITUATION APPEARS HAZARDOUS AND THE
TEMPTATION OF PROTECTIONISM EVER STRONGER.

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4. III - THE OBSTACLES TO IMPROVING PROSPECTS

THE DIFFICULTIES THAT STAND IN THE WAY OF AN IMPROVEMENT IN
PROSPECTS FOR 1978 AND 1979 DESCEND FROM THE INADEQUATE LEVEL
OF WORLD GROWTH AND THE TOO LOW RATE OF INCREASE OF WORLD TRADE.

THE STRATEGY OUTLINED IN MANILA IN 1976 ON THE OCCASION OF THE
ANNUAL MEETING OF THE IMF, WHICH ASSIGNED PRIORITY TO THE ADJUST-
MENT PROCESS, AND A SECONDARY ROLE TO MERE DEFICIT FINANCING,
HAS NOT PRODUCED THE HOPED FOR RESULTS.

A STRONGER EXPANSION OF DOMESTIC DEMAND IN THE COUNTRIES WITH
A BALANCE OF PAYMENTS SURPLUS HAS NOW BECOME PRESSING, EVEN IN
THEIR OWN INTEREST, BECAUSE THE CONTINUAL APPRECIATION OF THEIR
CURRENCIES VIS-A-VIS THOSE OF OTHER COUNTRIES MAY SET IN MOTION
A VICIOUS CIRCLE OF REVALUATIONS AND DEFLATIONS.

THE DISTINCTION THAT WAS DRAWN IN 1976 BETWEEN COUNTRIES ABLE
TO LEAD THE RECOVERY AND COUNTRIES WITH BALANCE OF PAYMENTS
PROBLEMS MUST BE REVIEWED IN THE LIGHT OF THE CHANGES THAT HAVE

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SINCE OCCURRED.

IN THE MEANTIME THERE HAS BEEN A DETERIORATION IN THE SITUATION
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OF THE UNITED STATES AS REGARDS BALANCE OF PAYMENTS AND INFLATION.
OTHER COUNTRIES HAVEHGHOWN AN IMPROVEMENT ON THESE TWO
FRONTS, BUT AT THE COST OF A MARKED ECONOMIC SLOWDOWN.
THE SURPLUS OF THE OPEC COUNTRIES DROPPED TO 35 BILLION DOLLARS
IN 1977 AND WILL FALL TO 23 BILLION IN 1978.

THE GRADUAL STRATEGY WHEREBY COUNTRIES MUST CONTRI-
BUTE TO WORLD DEVELOPMENT ACCORDING TO THE STRENGTH OF THEIR
BALANCE OF PAYMENTS POSITION IS STILL VALID, BUT IT IS NO
LONGER POSSIBLE TO DRAW CLEAR DISTINCTIONS BETWEEN DIFFERENT
GROUPS OF COUNTRIES: WE MUST LOOK TO INDIVIDUAL POSITIONS AND
FORMULATE POLICIES TO RESTORE EQUILIBRIUM CASE BY CASE.
BASICALLY THIS CONFIRMS THE LINE THAT EMERGED
AT THE MEETING OF THE ECONOMIC POLICY COMMITTEE OF THE OECD
ON FEBRUARY 27 AND 28 LAST, WHICH STRESSED THE ADVISABILITY OF
PURSUING A MODERATE AND DIFFERENTIATED RELAUNCHING OF THE
ECONOMY IN THE COUNTRIES UNLIKELY TO JEOPARDIZE THE RESULTS SO
FAR ATTAINED IN THE FIGHT AGAINST INFLATION.

TO CONCLUDE, UNLESS THERE IS AN ADEQUATE AND DIFFERENTIATED RE-
LAUNCHING OF THE WORLD ECONOMY AND AN EXPANSION OF WORLD TRADE,
NEITHER THE COUNTRIES IN A STRONG BALANCE OF PAYMENTS
POSITION NOR THE OTHERS WILL SUCCEED IN REDUCING THE UNEMPLOY-
MENT RATE (ESPECIALLY AMONG THE YOUNG) WHICH HAS BECOME ECON-
OMICALLY, POLITICALLY AND MORALLY INTOLERABLE.

5. IV - INVESTMENT PROSPECTS

THE PROSPECTS FOR INVESTMENT IN THE ITALIAN ECONOMY
ARE ILLUSTRATED IN THE GOVERNMENT PROGRAM, ALREADY MENTIONED
UNDER POINT C) OF THIS MEMORANDUM. THE SECTORS DUE TO RECEIVE
PUBLIC SUPPORT TO RELAUNCH PRODUCTION ARE, AS MENTIONED, ENERGY,
RAIL TRANSPORT, TELEPHONES, HOUSING, AND PUBLIC WORKS IN GENERAL.
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THE OBSTACLES TO THE GROWTH OF INVESTMENT IN ITALY IN
THE PRIVATE SECTOR ARE CREATED BY PROBLEMS OF LABOR COSTS AND
LABOR MOBILITY WITHIN THE SYSTEM, WHICH COMBINE WITH UNCERTAIN-
TIES AS TO THE PROFIT PROSPECTS OF SOVV FIRMS AND SECTORS THAT
HAVE BEEN EXPERIENCING DIFFICULTIES SINCE THE START OF THE OIL

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THE GOVERNMENT'S ECONOMIC PROGRAM AND THE
CHANGED CLIMATE OF RELATIONS BETWEEN THE SOCIAL PARTNERS ARE
BOUND TO HAVE A POSITIVE EFFECT ON PRODUCTIVITY AND ON THE
POSSIBILITIES FOR EXPANSION. HOWEVER, IN ITALY, WHICH IS CHIEFLY
AND INDUSTRIAL PROCESSING ECONOMY WHOSE NATIONAL INCOME
CONTAINS A LARGE FOREIGN COMPONENT, INVESTMENTS ARE
HEAVILY CONDITIONED BY THE PROSPECTS OF EXPORT TRADE AND
BY BALANCE OF PAYMENTS CONSTRAINT RELATING TO IMPORTS.
ITALY, THEREFORE, NEEDS A STABLE, PLENTIFUL FLOW OF
EXPORTS TO FEED ITS MORE LIVELY INDUSTRIES AND LIGHTEN
THE CONSTRAINT OF A BALANCE OF PAYMENTS BURDENED, OVER
THE NEXT FEW YEARS, WITH HEAVY REPAYMENTS OF FOREIGN
LOANS CONTRACTED IN THE PAST. THE SLACKENING OF THE
BALANCE OF PAYMENTS CONSTRAINT IS ITSELF ESSENTIAL
TO THE RECOVERY OF PUBLIC AND PRIVATE INVESTMENT, IN
VIEW OF THE CLOSE LINKS OBSERVED OVER RECENT YEARS BETWEEN BALANCE
OF PAYMENTS EQUILIBRIUM, INFLATION RATE AND PROSPECTS FOR THE
DEVELOPMENT OF EHE ECONOMY. END TEXT.GARDNER

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